In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 77-648

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

vs.

PENNZOIL PRODUCTION COMPANY, ET AL.,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF LAWRENCE LIGHTCAP AND WILLIAM T. LIGHTCAP (SUBSTITUTED FOR HARRY AND LELA LIGHTCAP), ET AL., AS AMICI CURIAE

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to receive the consideration bargained for by them in exchange for the extensive bundle of exclusive rights granted producers of natural gas, authorizing exploration upon, drilling into, laying of lines across, and numerous other related activities essential to the mining of lands potentially productive of natural gas.[2]

In the instant proceedings, No. 77-648, such landowner-lessors' common law rights are sought to be subjected to regulation by the Federal Energy Regulatory Commission ("Commission") in the complete absence of, and with apparent disregard for, the persons whose contractual rights may be affected. No landowner-lessors are now, or ever have been, parties to these proceedings, although their interests could be drastically affected by judicial response to the hypothetical issues propounded herein by the symbiont parties of record. Such parties, the petitioning federal agency administering sales of natural gas for resale in interstate commerce, and three of its regulatees, appearing here ostensibly as respondents, along with other regulatees which appeared in the court of appeals below, have a common interest in opposing the enforcement of such common-law contracts in accordance with their terms.

2. The conventional lease provides that the lessee has the exclusive right to explore and produce oil, gas and other hydrocarbons from the land. The landowner-lessor does not participate in those activities which reduce the minerals to possession, is not entitled to any of the profits resulting from those activities, and does not own any natural gas which the lessee reduces to possession. The owner of the lease, the lessee or his assigns, has legal title to all products resulting from the mining and manufacturing activities on the land, which result for the first time in personal property—natural gas which can become the subject of commerce. For a brief review of undisputed facts concerning the contractual rental arrangements embodied in a conventional oil and gas lease, see Brief of Respondents in Opposition, *Mobil Oil Corp.* v. *Harry Lightcap, et al.*, No. 76-1694, p. 3, n. 2.

By its choice of words, the Commission discloses a basic misunderstanding of the lease agreement. The Commission consistently refers to "royalty gas," "gas attributable to Williams' royalty interest" and phrases of like import. (Brief for the Federal Energy Regulatory Commission, pp. 6, 7, 8, 9, 10, 11, 15, 37, 38 and 40). "Royalty gas," under a conventional lease (as distinguished from overriding royalty carved out of the lessee interest and assigned by lessee, and gas delivered in kind to the lessor, both creating an ownership interest in the produced gas stream itself), does not exist, although the phrase may be sometimes used as a shorthand expression to describe that part of the lease rental computed as royalty related to the volume of production. Such use by the Commission of such phrases in the context of this case merely confuses the legal relationship between the lessor and lessee because it conveys the false impression that the lessor has an ownership or possessory interest or power of disposition in a portion of natural gas produced pursuant to a lease on his land.

Amici curiae, respondents in *Mobil Oil Corp.* v. *Harry Lightcap, et al.* (*"Lightcap"*), Case No. 76-1694, are lessors among that handful on whose lands leases have been construed by the Supreme Court of Kansas to entitle them to recover monthly cash rental, denominated as royalty, payable for the mining activities aforesaid in dollar amounts consisting of a stated fraction of the market value of gas found by lessee and turned by it, each such month, into personal property which can become a commodity of commerce in commercial quantities.

These landowner-lessors obtained judgment from the Supreme Court of Kansas on their contract claims against Mobil Oil Corporation, petitioner in *Lightcap*, some 15 years after suit was commenced. Such judgment was delayed for most of that period due to the unsuccessful, combined efforts of Mobil, Shell Oil Company ("Shell," a respondent herein) and numerous other federally-regulated natural gas producers to subject farmers to regulation by the Commission, petitioner in the instant case, No. 77-648. Without detailing here the history of such efforts,[3] suffice it to say that the supposed antagonists

3. The Brief of Respondents in Opposition, *Mobil Oil Corp.* v. *Harry Lightcap, et al.*, No. 76-1694, pp. 2-13 contains a detailed history of such prior efforts.

here were aligned together as parties of common interest in the federal judicial and administrative proceedings brought to forestall the state court judgments in *Lightcap*. Those efforts culminated in denial of certiorari by this Court to review the holding in *Mobil Oil Corp.* v. *FPC*, 463 F.2d 256 (D.C. Cir. 1972) that neither these very landowners (*amici curiae* here), nor the leases on their lands, nor the monthly cash payments required to be made to them under the leases are subject to federal regulation. *Mobil Oil Corp.* v. *Matzen*, 406 U.S. 976, *reh. denied* 409 U.S. 902 (1972). Such alignment still persists, as shown by the joint efforts of the Commission and Mobil to obtain rehearing of denial of certiorari in *Lightcap*[4], notwithstanding the ostensibly adversary positions assumed in this Case No. 77-648 by the Commission and Shell, former joint proponents with Mobil of federal regulation of such royalty in the prior proceedings aforesaid.[5]

As will be specifically demonstrated, the regulatee respondents in the instant proceedings are pecuniarily indifferent to the outcome herein, but are willing cohorts of their visitorial adversary, the Commission, appearing as petitioner here, in its continuing efforts to avoid the established principles governing the rights of landowner-lessors under oil and gas leases.

4. The Commission has urged this Court three times to reverse the Kansas Supreme Court's decision in *Lightcap* v. *Mobil Oil Corp.*, 221 Kan. 448, 562 P.2d 1 (1977), *cert. denied* 434 U.S. 876 (1978), *rehearing pending.* Memorandum for the Federal Energy Regulatory Commission as *Amicus Curiae* in Support of Rehearing, *Mobil Oil Corp.* v. *Harry Lightcap, et al.*, Case No. 76-1694; Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit, p. 10, n. 6; and Brief for the Federal Energy Regulatory Commission, pp. 35-37, the latter two filed in the instant proceedings.

5. At the request of the Court in *Lightcap*, made the same day that the petition for writ of certiorari was granted in the instant proceedings, *amici curiae* have filed in *Lightcap* their Memorandum of Respondents in Opposition to Petition for Rehearing, *Mobil Oil Corp.* v. *Harry Lightcap, et al.*, Case No. 76-1694.

The interests herein of landowner-lessors, the persons here whose rights are at stake, are obvious. It is sincerely hoped that the handicapped, limited presence of a few of such persons, as *amici curiae*, may be of some assistance in providing proper perspective regarding the actual nature of these proceedings and their appropriate disposition.

STATEMENT OF THE CASE

These present proceedings are collateral to, but procedurally and jurisdictionally wholly independent of, a Louisiana state lawsuit which has not been tried, is not stayed, and is still pending. The relief sought before the Commission below by respondents Pennzoil Producing Company ("Pennzoil") and Shell came in the garb of a proposed, but unconsummated, settlement of unadjudicated claims of uncertain outcome in such state court proceedings. The state court lawsuit is between Williams, Inc. ("Williams"), a lessor (who is not a party to these proceedings and was not a party to the Commission proceedings below or in the review proceedings in the court of appeals) and its lessees, respondents Shell and Pennzoil. The state court action involves the construction of a clause in two oil and gas leases owned by Pennzoil and Shell, as lessees. That clause specified periodic cash rentals, computed as royalty, payable by reason of lessees' exercise of the right and privilege of producing gas in paying quantities. The clause provides for such cash rental equal to fixed fractions of the "value" of all of the natural gas produced.[6]

6. Natural gas is valued on a per Mcf basis. One lease provides that such "value" is to be "calculated at the market rate prevailing at the well," while the second provides that such "value" is to be "calculated at the market price prevailing at the well." (A. 133, 145). The fixed fraction of such value is 1/8th in one lease and 1/4th in the other lease. (A. 133, 147).

The lessees, respondents Pennzoil and Shell, also happen to be natural gas companies subject to regulation by the Commission under the Natural Gas Act. They claim in that state court litigation that, by making payments to their lessor of such fixed fractions of the dollar amounts received by them under their regulated cost-of-service rates established for them by the Commission, they have discharged their contractual lease obligations, if properly construed, to pay such rental required to be computed by reference to the "value" of the natural gas. (A. 93). Williams asserts in the pending state court suit that the lessees Shell and Pennzoil have not fulfilled the rental obligations under their leases. (A. 112). A justiciable controversy thus exists in the state court between lessor and lessee, both parties to that lawsuit, over the measure of the royalty obligation under the leases.

The lessees, Pennzoil and Shell, managed to secure the conditional agreement of their lessor to settle that state court litigation upon the occurrence of either of two contingent events. Under the first alternative, they obtained their lessor's agreement to amend the lease to provide for computation of such royalty by use of a per Mcf factor equal to the highest allowable area or national rate for independent producers of gas,[7] if and only if, those lessees could relieve themselves completely of the resulting indebtedness. As natural gas companies, they proposed to do that by securing approval from the Commission to pass the resulting costs on to a conveniently acquiescing natural gas company, respondent United Gas Pipeline Company ("United"). (A. 16-20).

Under the second alternative, they got Williams, presently a mere lessor, to agree that it would itself become

7. *See* Brief of Respondent Pennzoil Producing Company in Opposition, p. 3, n. 4.

a natural gas company through an assignment to it of lessees' dominion and power of sale of an agreed upon portion of Shell's and Pennzoil's leasehold gas production. (A. 20-21). This second alternative would, in turn, be effective if, and only if, the Commission would authorize abandonment of such portion of the gas from the obligation of Pennzoil and Shell to continue the interstate service, which obligation Williams would otherwise assume through that assignment.

The proposed settlement agreement was presented to the Commission for approval. In its initial opinion, the Commission refused to sanction the first alternative of the proposed settlement agreement, because Pennzoil and Shell failed to show that their proposed additional costs necessitated individualized relief. (A. 32-36). Pennzoil challenged the Commission's initial opinion on the ground that it (Pennzoil) did not have an opportunity to introduce appropriate evidence to show its entitlement to individualized rate relief based on additional costs. The Commission granted both Pennzoil and Shell that opportunity. (A. 37-39).

In the subsequent evidentiary hearing before the administrative law judge, the judge concluded that Pennzoil and Shell could not demonstrate that they would be entitled to either type of relief they sought. Responding to the first alternative of the proposed settlement agreement, the administrative judge held that the evidence offered by Shell demonstrated that Shell could absorb the proposed additional payments which would arise from its conditional contractual obligation to Williams if it ripened into a lease amendment, without an increase in its rate.[8] As Pennzoil

8. The administrative judge commented:

"[E]ven if it were finally adjudicated by the state courts that the market value basis for royalty payments were 78

(*Continued on following page*)

did not even attempt to introduce the evidence to show its entitlement to rate relief, which it had contended it was entitled to offer, the judge accordingly denied Pennzoil's request for individualized relief. (A. 185).

Upon review, the Commission disregarded the undisputed evidentiary findings of the administrative judge which the Commission initially thought essential to the disposition of the case. It instead denied relief on a legal theory not even considered by the administrative judge. It concluded that even if, contrary to the undisputed findings of the administrative judge, Pennzoil and Shell could otherwise show entitlement to rate relief, the Commission had no authority to grant such relief under *FPC* v. *Texaco,* 417 U.S. 380 (1974). (A. 261, 291-292). The Commission stated that it "cannot permit any incremental royalty costs resulting from this settlement, or resulting from any judgment by a state court regarding royalty payments, to be passed on to the pipeline if these incremental royalty costs are based upon any other factors than the regulated just and reasonable rate." (A. 261). It later stated on rehearing that the language relating to a state court judgment (such as is before this Court in the *Lightcap* case) was dicta, meriting no further discussion. (A. 297).

The Commission also denied Pennzoil's and Shell's alternative request for abandonment of the agreed upon

Footnote continued—

cents of $1.40 per Mcf, or some other figure, the same issues would be present here. Pennzoil and Shell would have to establish on the basis of their own costs and revenues that they could not absorb the higher royalty payments without a price increase. This, Pennzoil has not even attempted to do. And Shell has failed in its attempt." (A. 185).

Shell's own evidence indicates that if it were to absorb the full extent of its contractual debt with its lessor, Williams, based on the payment of rentals computed at $1.40 per Mcf, instead of the lower negotiated settlement price, Shell and its shareholders would still realize a profit from its Williams lease in the amount of $168,514 annually. (A. 180).

portion of the natural gas owned by them which they proposed to convey and assign to Williams because the Commission realized that Williams, under such circumstances, would, itself, become a natural gas company through such conveyance of part of the lessees' interest. The Commission, relying on its decision in *El Paso Natural Gas Co.*, 54 F.P.C. 145 (1975) (later *aff'd sub nom. California* v. *Southland Royalty Co.*, ... U.S. ...., 56 L.Ed.2d 505 (1978)), stated that in the event of acceptance by Williams of such conveyance, "Williams would not be entitled to the status afforded a royalty owner by *Mobil Oil Corp.* v. *FPC*, 463 F.2d 256 (D.C. Cir. 1972), but would be a natural gas company making sales for resale of natural gas in interstate commerce subject to the Commission's jurisdiction."[9] (A. 263).

The court of appeals, accepting in the very first sentence of its opinion as fact the imaginary economic hardship placed upon Shell and Pennzoil, which directly conflicted with the record facts and the findings of the administrative judge, based its opinion on that unfounded imagi-

9. *Amici curiae*, as respondents in *Mobil Oil Corp.* v. *Harry Lightcap, et al.*, Case No. 76-1694, have never claimed that they are entitled to a judicial decree of cancellation by virtue of underpayment of rental in the form of royalty. Even if they had sought cancellation, Kansas law presumably would have denied them that relief. *Davis* v. *Chautauqua Oil & Gas Co.*, 78 Kan. 97, 96 P. 47 (1908). *Amici curiae* consequently believe that they should not advise the Court on the issue of abandonment, raised in the Commission's second Question Presented. Respondents Shell and Pennzoil argue that abandonment from interstate service is required because of Williams' lease cancellation claim in the Louisiana state court litigation. *Amici curiae* concur with the Commission's statement of law, quoted above, that a lessor under a conventional oil and gas lease is not a natural gas company because a lessor does not have dominion or power of sale over any portion of the natural gas produced under his lands. If lessor agrees, like Williams, to accept an assignment of dominion and power of sale over natural gas owned by his lessees, that lessor becomes a natural gas company.

nary hardship.[10] From that wholly erroneous and imaginary factual premise, it concluded that, without rate relief, Shell and Pennzoil could not generate sufficient funds necessary for further exploration and development.[11] In their certiorari papers filed herein, the Commission and respondents simply disregarded and failed to reveal to this Court those evidentiary findings showing that Shell and Pennzoil were not entitled to relief, all in a mutual attempt to place before this Court a purportedly justiciable controversy if a writ of certiorari were granted. Only after respondents in *Lightcap, amici curiae* here, drew that fact to the attention of this Court and the Commission in *Lightcap,* after its grant of writ of certiorari herein,[12] has the Commission in its Brief finally disclosed to the Court the evidentiary findings of the administrative judge in these proceedings.[13] (A similar duplicitous change of position

10. The first sentence of the opinion of the Court below demonstrates that it decided the case on the unfounded premise that an "economic bind" existed:

> "*Caught in the squeeze* between the regulated price of its gas, which price included royalty costs at the interstate price, and the claims of landowners for increased royalty payments based on higher intrastate rates, the gas producers petitioned the Federal Power Commission for relief." *Pennzoil Producing Co.* v. *FPC,* 553 F.2d 485, 486, 5th Cir. 1977 (emphasis added)

11. *Amici curiae* have attempted to reconstruct from the record the rate of return from the sale of natural gas produced under the Williams leases, in the event Shell and Pennzoil were required to pay royalty in accordance with the terms and provisions of the settlement agreement with Williams. Such a computation is impossible to make because Shell and Pennzoil failed to introduce evidence regarding their capital costs associated with the Williams leases. (A. 177). That failure may be due to the fact that Pennzoil and Shell may have long ago recovered all such capital costs in light of continuous production over a period of more than 20 years. (A. 88).

12. Memorandum in Opposition to Petition for Rehearing, *Mobil Oil Corp.* v. *Harry Lightcap, et al.,* No. 76-1694, pp. 6-7, filed in July, 1978.

13. Brief for the Federal Energy Regulatory Commission, filed herein in September, 1978, pp. 7-8 and 33-34.

after the granting of the writ of certiorari herein, involving the status of *Mobil Oil Corporation* v. *FPC,* 463 F.2d 256 (D.C. Cir. 1972), *cert. denied* 406 U.S. 976, *reh. denied* 409 U.S. 902-3 (1972) is discussed in footnote 19 and accompany text on pages 16-17 of this brief.)

The court of appeals was led to make a second assumption in its opinion that is also utterly contrary to the record facts. Although the court of appeals did not specifically conclude that the royalty obligations under the Williams leases required its lessees Shell and Pennzoil to pay royalty computed by reference to intrastate prices of natural gas, its opinion intimates or assumes, without any basis in law or fact, that the royalty clauses required computation of royalty solely on that basis.[14] As above stated, the proposed settlement agreement before the Commission in these proceedings would, if it became effective, modify the leases in this regard by providing for computation of periodic cash rentals computed with reference to the Commission's regulated rates.

The Commission has seized upon the two unfortunate mistakes in the opinion below and has built its entire case

14. The Court of Appeals based its conclusion that Williams demanded royalty based on "intrastate prices" from Williams' assertions in the March 27, 1974 letter it sent to respondents (A. 72-74) and its allegations contained in its Answer and Reconventional Demand in the Louisiana state court proceedings. (A. 114-115, 119-121). *Pennzoil Producing Co.* v. *FPC,* 553 F.2d 485 at 487. Williams did not disclose the method by which it calculated the values it used in those documents. In fact, it never referred to "intrastate prices" in those documents and the lessees in state court admit that Williams "set forth no theoretical basis" for such computation. (A. 92).

The Commission in its Brief here also asserts that the Williams claims were based wholly on "intrastate market values." Petitioner's Brief at p. 4. A careful review of the record does not support that assertion. Even if Williams claimed outside the record that it was entitled to royalty based on "intrastate prices," its mere assertion does not *ipso facto* establish the validity of that assertion without a state court construction of the royalty provisions in the leases.

for submission of landowner-lessors to its control on those two misstatements. Its putative adversaries, Pennzoil and Shell, in their certiorari papers, did not attempt to alert this Court to these errors.

Nor have the parties pointed out to this Court that these entire proceedings may be rendered moot at any time by unilateral action by Williams (not a party at any stage to this purported case or controversy) or by respondents, Pennzoil and Shell. The parties to the state court proceedings still pending unstayed have placed themselves in a position to play "kings-x" with this Court, depending on how things go here. The settlement agreement provides that if the Commission refuses or fails to approve the settlement agreement "or fails to issue other authorization acceptable to the parties hereto, on or before February 1, 1976," either Williams or Shell and Pennzoil may terminate the agreement by written notice to the other party. (A. 24). The unilateral termination date was extended one month until March 1, 1976. (A. 291). The agreement can be unilaterally terminated today.

In the event of termination of the conditional settlement agreement, and in the event this Court denies rehearing in *Lightcap,* the Court could in the future reach questions concerning the pass-through of so-called "market value royalties," based upon a state court judgment if, in fact, Mobil would later seek individualized relief after payment of the judgment in *Lightcap.* The judicial exception to the doctrine of mootness, embodied in the phrase "capable of repetition, yet evading review," accordingly would have no application in the event of termination of the conditional settlement agreement. *Cf., Roe* v. *Wade,* 410 U.S. 113 (1973). Likewise, the exception would have no application concerning the pass-through of so-called "market value royalties" based upon a settlement of other future or

pending "market value" royalty cases. This Court could review the action taken by the Commission in any case after a producer actually paid a settlement amount and then sought individualized relief from the Commission based on such payment. No review would be evaded.

ARGUMENT

The present posture of this lawsuit implicates the case or controversy clause, Article III, Section 2 of the Constitution, which establishes the constitutional limitation of this Court's jurisdiction. There are no legal or factual issues involved in these proceedings which can be or have been stated in terms of an actual case or controversy. By reason of this constitutional limitation, the order of this Court granting a writ of certiorari herein should be withdrawn as improvidently granted.

The Commission and respondents, by intimating as fact an imaginary hardship, based on hypothetical assumptions conflicting with the facts of record, have represented to this Court that their purported controversy, if accepted by the Court, raises justiciable questions. These proceedings are not the first time that a natural gas company has implored the Court to take cognizance of its purported economic plight hypothetically resulting from yet-to-be-performed compliance with the terms of common law lease agreements with landowner-lessors.[15] In *Mobil Oil Corp.*

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15. Petitioner in *Mobil Oil Corp.* v. *Harry Lightcap, et al.,* No. 76-1694, also makes the same unfounded claim of economic hardship as the Commission and respondents make herein. Mobil relies on various other cases filed by landowners. Reply Brief of Petitioner, *Mobil Oil Corp.* v. *Harry Lightcap, et al.,* Case No. 76-1694, pp. 1-2. Respondents cannot confirm or deny the validity of these calculations because Mobil did not introduce those calculations into the record. Respondents cannot even confirm or deny the assertion by Mobil that all the cases it lists deal with the same question raised in *Lightcap.* The first case listed, how-

(*Continued on following page*)

v. *FPC*, 417 U.S. 283 (1974), this Court also listened to the hollow economic lamentations of natural gas companies. This Court reminded those companies that "hypothetical" arguments cannot form the basis of reasoned opinions. 417 U.S. at 328. Such judicial opinions, merely advising the parties of the Court's inclination concerning issues based on a hypothetical set of facts, would necessarily exceed the constitutional limitations of the federal judiciary. *United States* v. *Freuhauf*, 365 U.S. 146 (1961). Here, Shell and Pennzoil have indicated in their certiorari papers that they not only wish the Court to grant them relief based on prophesies, as was urged in *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283 (1974), but would have the Court render an advisory opinion on the merits of an alleged controversy based on an imaginary hardship utterly disproved by the record.[16]

Footnote continued—
ever, does not address the question of additional royalty under "market value" leases. *Gray* v. *Amoco Production Co.*, 1 Kan. App. 338, 564 P.2d 579 (1977), *remanded with instructions*, 223 Kan. 441, ____ P.2d ____ (1978). Even assuming that each case listed by Mobil involves an exposure to the lessee of such landowner's claims, there is nothing in this record or in *Lightcap* which shows that payment of such claims, if reduced to judgment, would require their rates as producers to be adjusted upward.

16. If this Court denies rehearing in *Lightcap*, which we believe it should, or if Pennzoil and Shell enter into a good-faith unconditional arms-length settlement of their state court litigation with Williams, and if, in any such instance, the lessee-producer later pays the judgment or settlement amount and then seeks relief from the Commission based on actual costs incurred, then and only then on review in this Court will there be a justiciable controversy regarding the various subjects discussed as hypothetical abstract propositions in these proceedings. If it is thought that the producers are pressed for time, we draw the attention of the Court to the fact that this Court's determination in *Lightcap* will affect 280 cases brought on behalf of 257 landowners filed even before Kansas had statutory class actions and that 100 of these 257 landowners are now dead, 27 of their successors are dead, and at least 4 of the third generation have, in turn, died during the litigation. Memorandum of Respondents in Opposition to Petition for Rehearing, *Mobil Oil Corp.* v. *Harry Lightcap, et al.*, Case No. 76-1694, p. 12, n. 16.

The failure to illuminate the actual facts strongly suggests that the putative adversaries herein, the regulator and its regulatees, have united for purposes other than to resolve an actual controversy between them. This is demonstrated quite vividly by their maneuvering in the certiorari papers on the question of individualized rate relief. Respondents Pennzoil and Shell artfully fashioned the legal contentions throughout these proceedings based on an imaginary set of facts, in such a manner that the Court's ultimate disposition of this lawsuit on the merits would not jeopardize their interests. On one hand, they claim that under *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283 (1974), they are entitled to an *automatic* "pass-through" of their royalty obligations without showing that such a pass-through is necessary to assure them of "just and reasonable" rates. On the other hand, they reason that this Court should abrogate the contractual obligations of their leases in such a manner as to result in the same economic effect upon them.[17] The Commission, rather than alerting this Court in its petition for a writ of certiorari herein that respondents could not show entitlement to individualized relief, instead condoned the creation of an imaginary hardship in order to induce this Court to grant a writ of certiorari herein. It now sides in its Brief with respondents' second claim that the ultimate solution to the imagined hardship requires that this Court abrogate, in a review of Commission proceedings, and with the lessor not present, the royalty clauses in the manner suggested by respondents. This lawsuit is devoid of the actual clash of adversary positions necessary for a constitutional adjudication. *Moore* v. *Charlotte-Mecklenburg Board of Education*, 402 U.S. 47 (1971).

17. *See, e.g.*, Brief of Shell Oil Company in Opposition, p. 8, filed herein, in which Shell openly supports the Commission's view that this Court should reverse *Lightcap* v. *Mobil Oil Corp.*, 221 Kan. 448, 562 P.2d 1 (1977).

The Commission urges this Court to ignore the absence of a truly adversary proceeding herein and to ignore the fact that respondents have not shown themselves entitled to the individualized relief requested. It rather urges this Court to refuse to respect state common law and instead establish a new breed of "federal law" to defeat the landowners' claim in debt.[18] The Commission's argument is founded on the false premise that the imaginary bind of the natural gas companies can be relieved only through the creation of a new species of "federal law" governing rental payments to lessors under lease contracts, which payments and lease provisions the Commission concedes in its Brief, but only after the Court has granted a writ of certiorari herein, are outside the domain of the Commission's jurisdiction. Here again, this necessary concession came only after these *amici curiae* took issue with the representations to the contrary made by the Commission to this Court before certiorari was granted herein.[19]

18. Brief for Federal Energy Regulatory Commission, p. 37, n. 22.

19. *Amici curiae* admit that they are somewhat bewildered by the Commission's assertion that this Court should establish a new breed of federal law. The Commission, in its petition for a writ of certiorari, first suggested that this Court should reverse *Mobil Oil Corp.* v. *FPC*, 463 F.2d 256 (D.C. Cir. 1972), *cert. denied*, 406 U.S. 976, *reh. denied*, 409 U.S. 902-03, which decision held that the Commission has no jurisdiction (1) over lessors, or (2) over the payment of monthly cash rentals computed as royalties, or (3) over the rental provisions of oil and gas leases on their land. Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit, pp. 17-18.

After the filing by these *amici curiae* as respondents in *Lightcap*, Case No. 76-1694, of their Memorandum of Respondents in Opposition to Petition for Rehearing, which took issue with the Commission's views (p. 4 *passim*) has the Commission now unconditionally admitted its acceptance of the Court's holding in *Mobil*. It does not now press reconsideration of that case. Indeed, in its opinion below, here on review, it fully accepted and relied upon that 1971 *Mobil decision*. (See A. 260 and Brief for Federal Energy Regulatory Commission, p. 37, n. 22).

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This left-handed assertion regarding "federal law" is contrary to established law. The Court of Appeals in *Placid Oil Co.* v. *FPC*, 483 F.2d 880 (5th Cir. 1973), concluded that ascertainment of lease rental payments, computed as royalty, was not a question of federal law, but

> "an *Erie* determination of the contract stating the royalty percentage based upon the applicable principles of state law—totally beyond the control of the federal regulatory agency charged with the responsibility of regulating natural gas rates." 483 F.2d at 911.

This Court affirmed that opinion in *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283 (1974).

The Commission itself has created an imaginary bind because it has never acquiesced in or obeyed the rulings of the courts of appeal or of this Court that require royalty obligations to be treated as all other cost components entering into the rate structure of regulated natural gas companies. They did not "alter the departure point of the rate calculations" as required by *Placid*. 483 F.2d at 911. The Commission simply defiantly continues to refuse to treat what it describes as "royalty costs" as an exogenous cost, in the same manner as it treats all other production costs. All other costs entering into rates are determined by market forces, but the Commission computes the "royalty costs" as if they were derived from other combined costs, and thereby ignores the contractual obligations fixed by

Footnote continued—

The Commission's new argument, based on "federal law," appears to be that what *Mobil* forbids it to do directly, it can do indirectly. It wishes this Court to allow it to establish the permissible extent of royalty obligations, even though the Commission has conceded in its decision below and now concedes that the parties affected by its determination are not even subject to its jurisdiction.

the terms of lease contracts.[20] The Commission could easily correct the obvious deficiencies in the application of its formula as so required by *Placid* or, at least, grant individualized relief when such application places their regulated companies in an actual economic bind. But the Commission simply refuses to follow either of those courses.

The Commission, unlike the Courts, obviously believes that landowner-lessors are only entitled to those rentals that would incidentally trickle down to them, if any,[21] through its unchanged mode of implementation of jurisdictional rates for regulated companies. But, of course, the Natural Gas Act did not nationalize landowners' property rights. *See Panhandle Eastern Pipe Line Co.* v. *Public Service Comm'n*, 332 U.S. 507 (1947). Cognizant of that fact, this Court in *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283 (1974), appropriately responded to Mobil's complaint that the Commission failed to provide automatic adjustments in area rates to compensate for anticipated higher royalty costs which would conceivably result from the holding in *Mobil Oil Corp.* v. *FPC*, 463 F.2d 256 (D.C. Cir. 1972), *cert. denied* 406 U.S. 976, *reh. denied* 409 U.S. 902-3 (1972). In rejecting Mobil's claim for such automatic adjustments, this Court adopted the language of the court of appeals in responding to Mobil's contention:

> "If, as subsequent events develop, the producers are put in a bind by their royalty obligations, they may certainly petition FPC for individualized relief." 417 U.S. at 328 [quoting from *Placid Oil Corp.* v. *FPC*, 483 F.2d 880 (5th Cir. 1973)]

The Commission has failed to follow those directives. Had it done so, it would have denied Pennzoil's and Shell's requested rate relief on the ground that those natural gas companies could not show such entitlement. The Commission, instead, posed abstract questions by denying the requested relief on other grounds.

The Commission suggests that this Court in *FPC* v. *Texaco*, 417 U.S. 380 (1974), decided simultaneously with *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283 (1974), forbids it from considering costs of natural gas companies arising from payment of their rental obligations under their lease agreements, if such costs are "based on the unregulated price of gas in the intrastate market." This abstract question is contained in the Commission's first Question Presented in both its petition for writ of certiorari and in its Brief and forms the basis for its entire extenuated argument

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20. *See, e.g., Placid Oil Co.* v. *FPC*, 483 F.2d 880, 901, n. 22, which graphically illustrates the different cost components the Commission considers in establishing area and national rates. Royalty is calculated as an endogenous cost, a percentage of the other costs, none of which have the slightest bearing on the common law obligations which lessee assumed under its lease agreement. It is well established that rentals in the form of royalty are never determined with reference to the costs incurred by the lessee in the production of natural gas. *See, e.g., Matzen* v. *Hugoton Production Co.*, 182 Kan. 456, 321 P.2d 576 (1958), *Johnson* v. *Jernigan*, 475 P.2d 396 (Okla. 1970).

21. This reflects the utter cynicism with which the big oil companies and the Commission regard the rights of farmers because they are not engaged in any way in the oil and gas business, all as is reflected by testimony in support of the Commission's actions in the *South Louisiana Area Rate Case*:

> "Q. Do you consider that the bonuses and royalties paid by the producer to the lessor or landowner constitute economic rent to the landowner?
>
> "A. (Dr. Kahn) Yes.
>
> "Q. Does that mean there should be no compensation to the landowner?
>
> "A. Do you want my opinion or—it is a little hard to know how to answer this. In my judgment, there should be *no compensation* to the landowner, or his compensation *should be taken away from him by the government*." (Emphasis added)
>
> (Transcript of Proceedings in South Louisiana Area Rate Proceedings, p. 13,267)

based on *Texaco*.[22] There is no basis for its assertion that royalty under the Williams leases requires calculation based solely on "the unregulated price of natural gas in the intrastate market." Furthermore, the record in this case deals with a settlement agreement calling for royalty amounts calculated on the basis of federally established rates.

Even as a matter of abstract analysis, the Commission fails to distinguish between various possible bases for determination of the per Mcf or value factor entering into rental calculations. The lessor and lessee presumably could agree upon an Mcf or value factor based "solely on the unregulated price of natural gas sold in intrastate commerce." The Commission intimates that due to possible monopolistic power exerted by natural gas companies in intrastate sales, the price extracted by such companies could be distorted. It could be argued that an increment of the royalty payment made on that basis could correspondingly be attributable to such monopolistic influences. If a natural gas company attempts to seek rate relief after making royalty payments on that per Mcf basis, the Commission argues that *Texaco* forbids it from considering that requested relief. The lessor and lessee, on the other hand, could agree upon payment of rental computed with reference to the undistorted "market value" of natural

22. The Commission formulates its first Question Presented in its Brief in the following manner, with a similar formulation contained in its Petition for writ of certiorari:

> "1. Whether the Natural Gas Act permits the Commission to establish rates for interstate sale of natural gas that pass through to interstate consumers royalty costs *based on the unregulated price of natural gas in the intrastate market.*" Brief for Federal Energy Regulatory Commission, p. 2 (emphasis added)

The Commission continues to express that unfounded assumption at pages 4, 5, n. 4, 11, 12, 22, n. 13, 24, 25, 26, 31, 32, 33, 35 and 36 of its Brief.

gas. This type of royalty clause is present in *Lightcap*. Under this clause, any possible monopolistic distortions would be excluded in the determination of "market value."[23] If a regulated natural gas company demonstrates, upon a proper showing, that its payment of rental computed on that per Mcf basis requires it to seek rate relief, the Commission cannot justifiably rely on *Texaco* to deny such relief. *Texaco* does not prohibit jurisdictional rates to be calculated with reference to the undistorted "market value" of natural gas. In fact, *Texaco* actually equated the true market price of natural gas with "just and reasonable" rates which Congress under the Natural

23. The Kansas Supreme Court in *Lightcap* v. *Mobil Oil Corp.*, 221 Kan. 448, 562 P.2d 1 (1977) stated:

> "Where a lease calls for royalties based on 'market value' of the gas sold, in the absence of proof of a contrary intent, that value is the price which would be paid by a willing buyer to a willing seller in a free market."

One commentator on *Lghtcap* has observed:

> "If the unregulated price of gas is subject to monopolistic influences, the 'free market value' of gas may not represent the full increment in a producer's receipts that would accrue were the gas sold without restriction." Note, *Federal Regulation of Independent Oil and Gas Producers and the Royalty Interest—a Question of Value*, 26 KAN. L. REV. 309, 318 (1978)

In other words, a "market value" lease would entitle the lessor to rentals in the form of royalty in an amount which could be substantially less than an intrastate market price distorted by monopolistic influences.

The Commission asserts that the Kansas Supreme Court in *Lightcap* held that "market value" royalty clauses refer "to the unregulated intrastate market." Petitioner's Brief at pp. 5, n. 4, and 36. This, as stated above, is a misinterpretation of the holding in *Lightcap*. The Commission further alerts this Court to *Kingery* v. *Continental Oil Co.*, 434 F.2d 349 (W.D. Tex. 1977). *Amici curiae*, unlike the Commission, cannot conclude that that Court held that a "market value" royalty clause refers to an "unregulated intrastate market." In fact, that decision never mentions the "unregulated intrastate market."

Gas Act attempted to achieve.[24] Thus, the formulation of the Commission's first Question Presented is both factually unfounded and analytically erroneous.

Due to the interposition of the proposed settlement agreement in these proceedings, the Louisiana Parish court has not had an opportunity to construe the very leases which the Commission has now construed for its own purposes in order to pose a hypothetical question to this Court. *Amici curiae* must question the propriety of the Commission's request for an advisory decision from this Court based on the Commission's unilateral construction of common-law leases in the absence of the lessor. In

24. This Court in *Texaco* recognized the distinction between "the 'true' and the 'actual' market price" of natural gas, 417 U.S. at 899, a distinction which now the Commission urges this Court to ignore. The Court in *Texaco* quoted from its opinion in *FPC* v. *Sunray DX Oil Co.*, 391 U.S. 9, 25, which stated that the "true" market price undisturbed by monopolistic forces would correspond to the "just and reasonable rate" Congress intended to achieve through the passage of the Natural Gas Act. Mr. Justice Jackson, concurring in *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581 (1945), made the prophetic observation:

> "I should like to reverse this case, not because I think the rate reduction is wrong, but because I think that the real inwardness of the gas business as affects the future has been obscured by the Commission's preoccupation with bookkeeping and historical matter. Such considerations may be relevant to rate-base theories, but will not be satisfying to the coming generation that will look back and judge our present regulatory method in the light of an exhausted and largely wasted gas supply." 324 U.S. at 615.

The Commission, in a belated recognition of the serious problems Justice Jackson foresaw, has recently stated:

> "The commodity value of natural gas also plays a role in our price determinations. Our mandate is to achieve an adequate supply of natural gas at the lowest possible price. So long as gas is priced below its commodity value . . . there will be excess demand." FPC Opinion No. 770, ... FPC .... (1976), 10 FPS 5-295 at 5-378.

If the Commission truly believes that *Texaco* forbids it from establishing its "just and reasonable rates" calculated on the commodity or true market value of gas, it in its most recent national rate opinion ignores that belief.

essence, the Commission seeks to persuade this Court to perform the function of the Louisiana Parish court and in a manner wholly unwarranted by law or fact.

Respondents in their certiorari papers, failed to alert this Court to such inaccurate and hypothetical formulation of the Commission's First Question so presented. They have apologetically omitted to argue, before the Commission and court of appeals the merits of their absent lessor's views, explicitly and repeatedly excusing their action or inaction on the ground that they cannot be expected to carry the lessor's banner in these proceedings and then be later faced with their own printed arguments in state court.[25] They thus let the Commission's argument against the lessor go by default in a record devoid of any facts except copies of state court pleadings.

Respondents, instead, formulated an inappropriate question of their own. They argued to this Court that the question which this Court would consider on full review is whether or not they can recover prudently incurred royalty costs.[26] But, due to the conditional nature of the settlement agreement, the management of Pennzoil and Shell have relieved themselves of their management responsibility, necessary under that very theory, by shifting that management judgment to the Commission. In addition, under the settlement agreement, they have no economic exposure because they will pass on the whole economic impact of those costs. The management of Pennzoil and Shell, as well as that of United, need not exercise any judgment since, under the settlement agreement, they would not bear the economic burden. They

25. *See, e.g.*, Reply Brief of Shell Oil Company, p. 2, n. 1, *Pennzoil Producing Co.* v. *FPC*, 553 F.2d 485 (5th Cir. 1977).

26. *See, e.g.*, Brief of Respondent Pennzoil Producing Company in Opposition, pp. 1-2.

have avoided the exercise of the very management judgment which, on their own theory, must be tested by the Commission against a standard of prudence.

Another fallacy permeating the Commission's entire attenuated argument based on *Texaco* is that royalty *costs* of a regulated natural gas company may not be computed with reference to market value because, under *Texaco*, just and reasonable *rates* may not be exclusively so determined. The Commission is obviously blind to this glaring *non sequitur*. To make the argument sound, either the Commission must regulate all cost components so as to be a function of the ultimate just and reasonable rate, or else it must be said farmers sell gas in interstate commerce when they lease their lands. But the Commission admitted in its opinion below and now admits in its brief (but only after certiorari was granted), that landowner-lessors do not make sales of natural gas. The bulk of the Commission's brief assumes just the opposite of this admission.

This fallacy becomes even more apparent upon consideration of the very leases on Williams' land. In one lease, as it now exists and as proposed to be amended, the royalty is determinable as 1/8 of a value factor, while in the other, the obligation is based upon 1/4 of such a factor. Which fractional amount represents a proper cost? The Commission and the respondents have wholly ignored this question. Should the Commission be authorized by this Court to rewrite this bargained-for fraction to accord with some amount which, coupled with some per Mcf factor, will be consistent with some predetermined amount embedded in just and reasonable rates? Such questions are not rhetorical and should be openly and honestly addressed. Through addressing these questions, the Commission and respondents would reveal the legal absurdity of their mutual position regarding the per Mcf or value factor entering into the royalty calculations. But, if they were addressed, they could not be answered in this case.

This absurdity resulting from designed preoccupation with only one of the factors contained in the rental payment provisions of the conventional lease can be further illustrated. The royalty clause provides for royalty to be computed as (1) a specified fraction of (2) a specified value factor related to measured production. The Commission and respondents isolate out and concern themselves exclusively with the second factor. Due to the variability of the first factor, a lessee may, in fact, incur greater royalty costs from a lease which provides for payment as a fraction of the amount received under the producer's regulated rate than from one which expressly provides for a smaller fraction of a greater market value of natural gas. If the lessee's amount of leasehold production and all of its costs, other than royalty costs, were exactly the same under both leases and it then sought individualized relief, the Commission, under its understanding of *Texaco*, would flatly forbid rate relief under the second lease, even though the pass-through to the consumer would be a smaller amount than paid under the unobjectionable first lease. *Amici curiae* do not understand how the Commission and respondents can sensibly claim that such a result advances the objective of the Natural Gas Act of "afford[ing] consumers a complete, permanent and effective bond from excessive rates and charges." *Atlantic Refining Co.* v. *Public Service Comm'n*, 360 U.S. 378, 388 (1959).

Just as the per Mcf factor is just one of the factors in the royalty clause which governs the amount of periodic

cash rental payments, so, too, that entire clause itself is only one of the many terms and provisions of a multifaceted integrated lease document. Each term and provision is essential to the whole, and each is related to the other in terms of consideration exchanged, including monetary consideration, such as initial "bonus" consideration, delay rentals and provisions for surface damages, etc. The Commission obviously cannot be permitted to take a bite out of this comprehensive real estate arrangement because to so do would spoil the whole of the unregulated transaction.

CONCLUSION

Any brief or presentation at this late stage cannot substitute for the shaping of issues of fact and law in an adversary proceeding necessary for a case and controversy ripe for decision by this Court. This case was not adversary, as the lessor was not present. Indeed, the lessor is a captive of the lessees under the terms of a settlement agreement which was conditional upon approval by a Commission that had no jurisdiction over the lessor or over the lease agreement.

Amici curiae are convinced that had either the petitioner or respondents been forthright, open and candid with this Court in their certiorari papers herein, this Court would not have granted the writ of certiorari. The parties assumed distorted facts and issues to make it appear that a justiciable controversy actually existed involving rights of absent lessors. They sought resolution of abstractly posed questions, any answer to which would have to be to their mutual benefit. This Court, now having been alerted to the lack of a justiciable case or controversy,

should dismiss the writ of certiorari granted herein, as having been improvidently granted.

Respectfully submitted,

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